IN THE

Supreme Court of the United States

October Term, 1977

No. 77-1638

JAMES E. CRANE; JAMES E. CRANE, M.D., P.C.; and JAMES E. CRANE and MARY ELLEN CRANE, Trustees of James E. Crane, M.D., P.C. Pension Trust (on behalf of themselves and investors similarly situated),

Petitioners,

v.

LESLIE A. BARTH; BERGMAN AND BARTH, P.C.; PIERSON, DUEL & HOLLAND; and RITCH, GREENBERG & HASSAN,

Respondents.

BRIEF OF RESPONDENT PIERSON, DUEL & HOLLAND IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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Question Presented

Whether this Court should grant certiorari to review the unanimous decision of the Court of Appeals affirming the District Court's dismissal of petitioners' second amended complaint, with prejudice, which alleged fraud violations

of the securities laws by the respondent law firm, on the grounds that (a) the complaint failed to allege fraud with the particularity required by Fed. R. Civ. P. 9(b), and (b) the complaint failed to state a claim against the respondent law firm because it did not allege any relationship between respondent and the preparation of the allegedly misleading offering brochures so as to create a duty of disclosure.

Statement of the Case

1. Nature of This Case and the Parties

This lawsuit arose out of the financial collapse of Stonehenge Industries, Inc. ("Stonehenge"). Stonehenge acquired various parcels of income-producing real estate, transferred those parcels to limited partnerships, and then sold interests in the limited partnerships to investors as real estate tax shelters. Petitioners purchased interests in three different partnerships. When their investments failed, petitioners sued under the federal securities laws, claiming fraud and deception by Stonehenge, its officers and directors, the person who sold certain real estate to Stonehenge, the sales representative of Stonehenge, and every lawyer and accountant who rendered any professional services to Stonehenge. Included was respondent Pierson, Duel & Holland, a small law firm in Greenwich, Connecticut, which rendered real estate services to Stonehenge.

This lawsuit has not progressed beyond the pleading stage. Respondent and the other professional defendants have successfully moved to dismiss the original and amended complaints on the grounds that (a) the complaints did

not contain specific averments of fraud as required by Fed. R. Civ. P. 9(b), and (b) the complaints failed to state a cause of action under the securities laws. The dismissals were unanimously affirmed by the Court of Appeals for the Second Circuit, which also denied petitioners' motion for a rehearing. These proceedings are discussed below in detail. Essentially, petitioners' request for certiorari seeks yet another exhaustive factual analysis of their complaint in the hope that this Court will find it sufficient.

2. The Proceedings Below

The original complaint filed on November 26, 1975 alleged violations of §17(a) of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. §77q(a), §§10(b), 15(c) and 20(a) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. §78j(b), §78o(c) and §78t(a), respectively, and S.E.C. Rules 10-b, 10b-5 and 15c 1-2. Since Pierson, Duel & Holland had nothing whatsoever to do with the preparation and distribution of any brochures and circulars or with Stonehenge's sale of limited partnership interests, and since the complaint set forth no facts to the contrary, respondent moved to dismiss the complaint on the grounds identified above. Respondent also moved for summary judgment based on affidavits in which Pierson, Duel & Holland unequivocally stated that it played no part whatsoever in the sale of limited partnership interests to petitioners or anyone else; that it never prepared any offering circular or other sales document; never issued any opinion or made any statement contained in any offering circular or sales document; never authorized the identification of the law firm in any offering circular as an expert in any field or as having passed upon any matter contained in the

offering circular, and never had any involvement with the securities aspects of any offer or sale of limited partnership interests by Stonehenge.*

Petitioners' original complaint was dismissed with leave to replead. An amended complaint was filed on June 14, 1976 but it was as deficient as the original and respondent again moved to dismiss and for summary judgment. On September 7, 1976 the District Court dismissed the amended complaint as to Pierson, Duel & Holland, stating that it "fails utterly to set forth a specific fact from which it could be concluded that there is a connection between the defendant law firm and the alleged wrongful conduct" and that it lacked the specificity mandated by Rule 9(b).

Petitioners were permitted to file a second amended complaint, which they did, and again respondent moved to dismiss and for summary judgment.** The District Court dismissed the complaint, with prejudice, noting that it was the "third time that the court has been presented with a motion to dismiss" for petitioners' failure to comply with Fed. R. Civ. P. 9(b), and that although the third complaint was "facially rearranged," it contained no greater specificity than before" (108a).† The court carefully reviewed

* The lower courts never ruled on respondent's motion for summary judgment since, in each instance, the complaint was found to be legally insufficient.

** The second amended complaint added an alleged violation of §12(2)q of the Securities Act, 15 U.S.C. §771(2) and dropped certain earlier allegations. The remaining Federal claims are under §10(b) of the Exchange Act and §§12(2) and 17(a) of the Securities Act.

† Numerical references followed by the letter "a" are to pages in the Appendix.

the allegations in the complaint and concluded that it did not satisfy Rule 9(b) for the following reasons:

> "It is apparent from a reading of this complaint that the heart of this alleged fraud was the preparation and distribution of various brochures and circulars and material omissions in them. Plaintiffs have failed to allege any set of facts that tie this defendant to the preparation of those brochures. The bald assertion contained on paragraph 41 that '[t]hose brochures were prepared by defendants Leslie A. Barth; Bergman and Barth; Pierson, Duel & Holland; Ritch, Greenberg & Hassan; and Donald Lawrence' is not sufficient. It gives no notice to this defendant as to what specifically it is alleged to have done wrong. It is exactly this type of joint accusation which forced the court in *Lincoln National Bank* v. *Lampe,* 414 F. Supp. 1270, 1278 (N.D. Ill. 1976), to dismiss the complaint in that case." (110-111a)
>
> "There is no indication as to which of the various brochures and circulars contained these false statements, what the statements were, why they were false, or who were responsible for them. These are not statements of fact, merely conclusions and therefore insufficient to satisfy Rule 9. *Shemtob* v. *Shearson, Hammill & Co.,* 448 F.2d 442 (2d Cir. 1971)." (110a)

The court also concluded that the complaint failed to state a cause of action for the following reason:

> "Furthermore, even assuming that this defendant had knowledge of various facts that plaintiffs have alleged to have been omitted from the brochures, as enumerated in paragraph 37, the complaint fails to state a claim against this defendant. '[M]ere possession and non-disclosure of material facts does not alone create liability under Rule 10b-5; there must be, in addition, some relationship which generates a duty to inform.' *Gold* v. *DCL, Inc.,* 399 F. Supp. 1123, 1127

(S.D.N.Y. 1973). Plaintiffs have failed to establish any relationship between this defendant and the preparation of the questionable brochures, and thus there can be no liability for failure to disclose." (111-112a)

Thereafter, the Court of Appeals unanimously affirmed the final dismissal on the opinion of the District Court, and unanimously denied a petition for rehearing (118-122a).

Reasons for Not Granting Certiorari

Petitioners have filed three lengthy complaints listing a litany of supposed acts, misrepresentations and omissions of Stonehenge, its officers, and a seller of properties with whom they dealt. None of the acts, misrepresentations or omissions was attributed to this respondent. Petitioners claim that respondent should be liable because it "knew or should have known" or "willfully and recklessly disregarded" the situation; because it did nothing and said nothing.

Every one of petitioners' complaints was exhaustively analyzed by the District Court. The final complaint was analyzed twice by the Court of Appeals. The decisions of those courts were emphatic and unanimous in finding the complaint to be insufficient. There is no reason whatsoever for this Court to conduct another exhaustive factual analysis. The decisions below were correct, and there is no basis for seeking certiorari.

There is no conflict among the decisions of the circuit courts of appeal, and no conflict between those decisions and learned authority concerning the purpose, interpretation and implementation of Rule 9(b). Similarly, there is

no conflict among authorities on the legal test for whether a complaint has stated a cause of action. All of the circuit courts which have addressed the issue have endorsed the basic legal principle that before a person will be held liable for non-disclosure under the securities laws, there must first exist a relationship which imposes a duty to disclose.

Each case of this type will turn on its own peculiar facts. The District Court and Court of Appeals have reviewed the facts at bar, have considered petitioners' exposition of their claims both orally and in briefs, and have concluded that even if all of petitioners' allegations were true, they are procedurally and substantively insufficient. Another review of this judgment would not produce a contrary result, nor could it give guidance to the bench or bar in other cases.

The true question posed by the petition is whether the Supreme Court should review every complaint dismissed for legal insufficiency to determine whether the Supreme Court's factual analysis is consistent with that of the District Court and the Court of Appeals. A grant of certiorari in this case simply would convert the Supreme Court into the third stage of a three-tier procedure under which every litigant could seek three successive reviews of his complaint, no matter how defective its form or content. It would reward, rather than discourage, the filing of complaints based on insufficient legal and factual research. It would enable hip-shooting litigants to coerce cost-of-litigation settlements at the expense not only of the defendants, but of the federal courts which will be burdened with endless reviews of claims which cannot pass muster.

ARGUMENT

I

There Is No Conflict Concerning the Purpose, Interpretation and Implementation of Fed. R. Civ. P. 9(b).

Fed. R. Civ. P. 9(b) states in relevant part:

> "In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity."

This rule repeatedly has been enforced in securities lawsuits against attorneys and accountants. Also, courts repeatedly have stressed the three distinct purposes for Rule 9(b)'s specificity requirement:

> 1. To inhibit the filing of a complaint as a pretext for discovering unknown wrongs. A complaint alleging fraud should serve to redress a wrong, not to find one.
>
> 2. To protect potential defendants from the harm which comes to their reputations when they are charged with the commission of acts involving moral turpitude, especially where the potential defendants are professionals, whose reputations in their field of expertise are most sensitive to slander.
>
> 3. To ensure that allegations of fraud are sufficiently concrete and particular enough to give notice to the defendants of the conduct complained of so as to enable the defendants to prepare a defense.

Rich v. *New York Stock Exchange,* 522 F.2d 153, 158 (2d Cir. 1975); *Segan* v. *Dreyfus Corp.,* 513 F.2d 695, 696 (2d Cir. 1975); *Felton* v. *Walston and Co., Inc.,* 508 F.2d 577, 581-82 (2d Cir. 1974); *Segal* v. *Gordon,* 467 F.2d 602, 607-08 (2d Cir. 1972); 5 Wright & Miller, *Federal Practice and Procedure,* Civil §1296.

Petitioners have cited no contrary authority, and refer to only two inapplicable circuit court decisions, which we discuss below, *Tomera* v. *Galt,* 511 F.2d 504 (7th Cir. 1975) and *Dudley* v. *Southeastern Factor and Finance Corp.,* 446 F.2d 303 (5th Cir. 1971), *cert. denied,* 404 U.S. 858 (1971).*

In *Tomera,* the complaint alleged purchases of notes and stock in reliance upon false representations that defendants held valid mine leases, were carrying out mining operations, and planned to use the funds invested by the plaintiffs in developing a mine and its operations. Attached to the complaint was a joint venture agreement signed by nearly all defendants which "set out more than enough details of defendants' common purpose and their control over the defendant corporation." The Fifth Circuit concluded that the complaint, in its entirety, had specified the fraudulent representations attributable to both the individual and corporate defendants.

The facts of *Dudley* were as follows: "ITCC" was a preferred shareholder of "SEFAF." SEFAF's assets principally were comprised of stock holdings in Atlantic Services, Inc. ("Atlantic"). SEFAF adopted a plan to liquidate under which the Atlantic stock was to be distributed to SEFAF's creditors and shareholders. In the course of the liquidation, nothing was distributed to ITCC. ITCC claimed that the transaction left it with preferred shares in a corporation lacking an operative existence. *Dudley* held that the liquidation constituted, in effect, a forced sale of ITCC's shares in SEFAF which afforded it standing as a "seller" to sue under the Exchange Act. The sole reference to Rule 9(b) was in footnote 6, on page 308, which stated that where the complaint specifically described

* *Dudley* was cited but not discussed in the petition.

the above transaction, and that Atlantic and SEFAF both were aware of but ignored ITCC's position as a preferred shareholder entitled to participate in the plan of liquidation, these allegations were sufficient under Rule 9(b). There is nothing in *Dudley* inconsistent with the Second Circuit's interpretation of Rule 9(b)—it is just another case-by-case application of the established rule. Similarly, the four district court cases cited in the petition are just additional examples of where courts have made a case-by-case analysis of a particular set of facts.

Furthermore, the two district court cases discussed in the petition were mischaracterized.* In *Fox* v. *Prudent Resources Trust*, 382 F. Supp. 81 (E.D. Pa. 1974), the complaint specified misstatements in a prospectus upon which the plaintiffs relied. In *Cash* v. *Frederick & Co., Inc.*, 57 F.R.D. 71 (E.D. Wis. 1972), the plaintiffs identified the applicable NASD Rule and situation in which a stockbroker violated his duty to make a proper investigation prior to recommending the purchase of a specific security where the plaintiff had relied on such advice to his detriment.

Petitioners' citation of these cases underscores the morass which will confront this Court should it grant certiorari in a case such as this. Indeed, the citation to these cases is of questionable value in light of this Court's observation that certiorari is not warranted unless there is a conflict in decisions between circuits. *General Talking Pictures Corp.* v. *Western Electric Co.*, 304 U.S. 175 (1938). See also Stern and Gressman, *Supreme Court Practice* (4th Ed. 1969), Sec. 4.8

* The two other district court cases cited but not discussed in the petition will not be treated here.

It is apparent that petitioners have wholly failed to identify any conflict among legal authorities and that their petition simply disputes the factual analysis of the complaint by the courts below. In such circumstances a writ of certiorari should not be granted. *United States* v. *Johnston*, 268 U.S. 220, 227 (1925); *Southern Power Co.* v. *North Carolina Public Service Co.*, 263 U.S. 508 (1924); *Rogers* v. *Missouri Pacific R.R. Co.*, 352 U.S. 500, 524 (1957) (Frankfurter, J., dissenting).

Petitioners' final plea, that the effect of the decision below is to exclude small and medium investors from access to the Federal courts (Petition, p. 22), is belied by their ability to have three complaints reviewed time and again by the District Court and Court of Appeals. The question is not of access, but of petitioners' failure to meet a threshold burden of stating a basic claim cognizable under the Federal Rules. Instead of filing one rehashed complaint after another, petitioners should have heeded Judge Weinfeld's admonition in *Miller* v. *Schweickart*, 413 F. Supp. 1059, 1061 (S.D.N.Y. 1976) that numerous defendants should not be named, in blunderbuss fashion, in a variety of charges based only on a slight relationship with those actively involved in the affairs of a company subject to litigation; that claims should be commenced only against those as to whom plaintiffs could confirm a basis for suit, and that discovery should be employed to determine if additional party defendants are warranted. Petitioners had more than two years to conduct such an investigation in this case. Petitioners repeatedly demonstrated their awareness of depositions conducted by the S.E.C. in actions against the Stonehenge officers allegedly responsible for petitioners' losses.* Given

* Plaintiffs also knew that although the S.E.C. investigated and commenced actions arising out of the Stonehenge collapse, no charges ever were lodged against respondent.

these facts, the necessary conclusion is that petitioners either failed to make the requisite initial investigation or, having done so, failed to uncover any basis for implicating respondent. In either event, petitioners have not been excluded from access to the f deral courts. Numerous prior decisions have admonished plaintiffs to investigate the involvement of specific defendants in fraudulent activities and not to file a fraud suit in the absence of specific allegations because the severe damage to the reputation of an attorney who has spent years developing a practice based on integrity, ability and industry may be impossible to undo.

II

There Is No Conflict of Authority on the Need for a Duty to Disclose as a Condition Precedent to Securities Law Liability Arising Out of Inaction or Silence.

The court below concluded that petitioners failed to plead any relationship between the respondent law firm and the preparation of the questionable brochures, and that absent such a relationship there could be no liability for the alleged possession and non-disclosure of material facts (111-112a).

Once again petitioners have shown no conflict of authority on this legal principle. They simply cite two cases, without discussion, for the proposition that a duty of disclosure exists merely where the name of the defendant attorney is used in connection with the sale of securities (Petition, 23). Petitioners' contention and their authorities are in error.

Black & Co. v. *Nova-Tech, Inc.*, 333 F.Supp. 468 (D. Ore. 1971) involved a district court holding that attorneys were subject to the long-arm jurisdiction of Oregon where they prepared legal papers necessary for a corporation to complete its sale of securities and authorized the issuer to use the law firm's name as corporate counsel on its annual reports. *Lewis* v. *Walston & Co., Inc.*, 487 F.2d 617 (5th Cir. 1973) imposed absolute liability on a broker-seller in the sale of unregistered securities and has no conceivable relationship to the issue at bar. Petitioners' citation to two cases concerning the liability of accountants is equally misleading. The cases are also decisions of the Second Circuit, the very circuit which rendered the decision below. *United States* v. *Natelli*, 527 F.2d 311 (2d Cir. 1975) involved criminal charges against an accountant who knowingly issued false and misleading financial statements. *United States* v. *Benjamin*, 328 F.2d 854 (2d Cir. 1964), *cert. denied*, 377 U.S. 953 (1964) imposed liability on an auditor who knowingly issued false and misleading financial statements to promote the sale of unregistered securities.

Petitioners have ignored an unbroken line of circuit court decisions in accord with the legal standard imposed by the Second Circuit. It is crystal clear that before an attorney has a duty to disclose alleged errant conduct of his client, it must first be shown that the attorney uttered some statement, representation or opinion which was misleading and which was relied upon by the plaintiffs. Time and again courts have rejected the extraordinary theory that an attorney will be liable as an aider and abettor for failing to disclose knowledge of a client's activities absent a prior undertaking by the attorney of some obligation to

the purchaser. *Lanza* v. *Drexel & Co.*, 479 F.2d 1277 (2d Cir. 1973); *Wessel* v. *Buhler*, 437 F.2d 279 (9th Cir. 1971); *Woodward* v. *Metro Bank of Dallas*, 522 F.2d 84 (5th Cir. 1975); *S.E.C.* v. *Coffey*, 493 F.2d 1304, 1316-17 (6th Cir. 1974); *Rochez Bros., Inc.* v. *Rhoades*, 527 F.2d 880, 889 (3d Cir. 1975), *cert denied*, 425 U.S. 993 (1976).

Since the legal standard for imposing securities law liability on the basis of silence or inaction is so well established and in accord with the decision below, petitioners' request for certiorari necessarily must rest upon their displeasure with the lower court's factual analysis of their complaint. For the reasons previously discussed, certiorari is not justifiable in such circumstances.

Conclusion

The foregoing analysis demonstrates that petitioners have failed to present this Court with any of the traditional bases for the granting of certiorari. There is no conflict of authority on any legal proposition. There is no important question of law to be resolved. This case does not differ from innumerable situations which require their own particular factual analyses in light of established law. Accordingly, the writ for certiorari should be denied.

Respectfully submitted,

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